



**Statement of the Hon. Larry Levitan,
Chairman, IRS Oversight Board**

**Testimony Before The Subcommittee on Government Efficiency,
Financial Management and Intergovernmental Relations
of the House Committee on Government Reform**

April 15, 2002

Mr. Chairman, and members of the Subcommittee, thank you for holding this hearing and inviting me to testify. It is an honor for me to appear before your committee today on behalf of the IRS Oversight Board to discuss IRS performance and the successful transition of IRS to a performance-based organization.

Let me preface my remarks by provide a brief explanation of the role of the IRS Oversight Board. The board was created as part of the IRS Restructuring and Reform Act of 1998. That legislation assigns the Oversight Board the responsibility for overseeing the IRS in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws. These duties closely resemble those of a governance board, in that it has responsibility for overseeing the strategic management process and approving the strategic plan, performance and budget submissions. Another key responsibility of the board is recommendation of candidates for appointment as Commissioner of IRS.

In its 2001 Annual Report, the Oversight Board reported that the IRS is still not effectively and efficiently serving the needs of the American taxpayers, although it has made significant progress since 1997. Customer service, although improved, has not risen to desired levels and enforcement activity has fallen for many years. These problems are compounded by outmoded computer systems that handicap IRS workers and prevent effective service from being delivered. It is not surprising that this environment has resulted in dissatisfied taxpayers, inadequate job satisfaction among IRS employees and difficulty in achieving improved performance.

On the positive side, the IRS is making progress and has put in place several key elements that establish a foundation for further progress. Under Commissioner Rossotti's leadership, the IRS has made major strides in the last few years. Commissioner Rossotti was instrumental in establishment of a well-formulated, high quality strategic management and planning process. The board has high praise for the IRS strategic assessment process implemented by the Commissioner as part of the budget and performance plan formulation activities. He also implemented the use of balanced measures across IRS. Other key elements that form the foundation for further progress include a Commissioner with a fixed term and a management background, a major reorganization designed to better focus on customer needs and provide clear

accountability, a strengthened senior management team, and a business systems modernization program that will eventually provide modern business processes and tools for employees and taxpayers. The entire modernization effort is being conducted in accordance with a strategic plan that has been approved by the Oversight Board, and monitored by balanced performance measures that will provide Congress, the Administration, the Oversight Board and other stakeholders a quantitative means to evaluate progress.

Neither the IRS nor the Oversight Board is satisfied with the state of the IRS' performance as reported in the Oversight Board's 2001 Annual Report. Performance measures for the key areas of customer service and enforcement are troubling to the Oversight Board. The board has recently implemented quarterly reviews of IRS performance that focuses on three dimensions of improvement: productivity (including timeliness and quality), customer satisfaction, and employee satisfaction. In the annual report, the board noted the deficiencies in telephone service. Progress is being made in this area and IRS is beginning to see positive results. For example, we have seen some significant improvements in timeliness and quality of IRS telephone service over the last few years, particularly in the opening months of the 2002 filing season. This can be attributed to an improvement plan that includes meaningful measures and execution of that plan. Although progress is being made, it is slower in some areas. In some cases, the full ranges of balanced measures are in the development stage. Others have only recently established baselines. Quality levels at IRS walk-in sites are just being baselined and need attention. Because of the link between employee and taxpayer satisfaction, employee satisfaction levels for these and other operations also need improvement.

With respect to compliance, the Oversight Board is concerned that the broad decline in enforcement activity increases our reliance on voluntary compliance, and fears that the public's attitude towards voluntary compliance is beginning to erode. Because of this concern, the Oversight Board initiated a survey to obtain data on taxpayers' attitudes regarding their obligations to report and pay their fair share of taxes. The survey, taken in August 2001, asked two questions from an earlier 1999 IRS survey and three new questions.

The survey results are included in the annual report, but the most troubling result was in response to a question that asked how much, if any, do you think is an acceptable amount to cheat on your income taxes. In 1999, 87 percent of the respondents replied "not at all." In 2001, the percentage of respondents who selected that answer fell to 76 percent.

The Oversight Board is reluctant to assign too much importance to a single survey, but intends to repeat the survey in 2002 using the same questions. There is cause for alarm if this trend continues.

As the audit rate falls, areas of noncompliance that need attention continue to be troublesome. Let me provide some examples. The IRS has just started to match pass-through income reported on Form K-1 to individual tax returns. The IRS estimates that perhaps \$100 billion of pass-through income is unreported every year.

One example of an emerging compliance problem is a recent IRS report that estimates that up to two million Americans have offshore credit cards, a number larger than previously believed, which can be used to hide spending patterns and income from the IRS.

Additionally, in December 2001 the IRS announced a temporary disclosure initiative designed to encourage greater voluntary disclosure. Through April 23, 2002, taxpayers could disclose to the IRS questionable transactions and other items that may result in an underpayment of tax. In return, the IRS will waive any accuracy-related penalty that might be applicable if additional tax ultimately is due. As a result of this initiative, the IRS expects to receive over 300 disclosures, which will enable it to pursue promoters, identify taxpayers who have not disclosed reportable transactions, and evaluate new types of transactions.

Lastly, a recent Treasury study found that nearly one-third of the \$31.3 billion in earned-income-tax-credit refunds sent out for the 1999 tax year -- between \$8.5 billion and \$9.9 billion annually, shouldn't have been paid.

These four items highlight what I might call a good news/bad news situation. On one hand, the IRS is becoming more knowledgeable about noncompliance. However, falling compliance resources make it difficult to assign additional resources in any meaningful way to investigate these situations and enforce the tax law with noncompliant taxpayers.

To better understand compliance issues, the Oversight Board believes there is an urgent need for the IRS to increase its research on taxpayer compliance so it can identify and correct broad areas of taxpayer noncompliance. The IRS is developing a new program, the National Research Program (NRP), that will provide the necessary research. Past approaches were viewed by Congress and taxpayers as too intrusive, and the IRS is designing the NRP to lessen taxpayer burden while still obtaining a sample sufficient to produce meaningful results. The Oversight Board supports the NRP and requests Congressional support for this program.

An effective IRS is an important part of our government, and the IRS can ill afford to fall behind. Old technology, a growing economy with more tax transactions, reduced IRS staffing levels, and an increasingly complex tax code have created a situation where the IRS must make up a lot of ground. The Board believes that a private sector company that fell behind this dramatically would find its very survival threatened. However, failure is not an option for the IRS. Our society depends on a tax administration agency that can help taxpayers understand and meet their tax obligations and effectively enforce the tax laws.

The long-range solution to many of the IRS' problems is to modernize its business processes and information technology. The IRS' Business Systems Modernization (BSM) program is designed to transform both IRS' business processes and information technology into modern, efficient processes and systems that incorporate world-class best practices. The BSM program has been progressing slowly, limited primarily by IRS' capacity to manage the program. Efforts from inception to date have focused on establishing an enterprise life cycle, a standard architecture, and low-risk projects. In 2002, however, several major deliverables are scheduled, and the upcoming year will be a test of the IRS' ability to manage this program.

The longer it takes the IRS to modernize, the longer taxpayers will be deprived of the benefits of improved IRS processes and systems, and be forced to endure the inadequacies of antiquated systems in place today. Even under the best of circumstances, it will take the IRS far too long to complete its modernization program. The Oversight Board recommends that BSM be accomplished as quickly as possible, consistent with the IRS' ability to manage the program and absorb change. The private sector has already learned that accomplishing programs in as short a period as practical actually lessens overall cost and risk. To increase the pace of modernization, all organizations involved in BSM must do a better job. The Oversight Board's recommendations for key organizations include:

- The IRS must improve its program management ability, work more effectively with the PRIME Contractor, and manage/implement change more effectively.
- The PRIME Contractor must understand and achieve its responsibilities to deliver business results within budget and on schedule and improve its breadth and depth of skills.
- The Administration must understand the importance and critical nature of the situation, support the long term plan, including increased investment levels, and hold the IRS responsible for meeting the plan.
- The Congress must accomplish the same tasks as the Administration, and, in addition, speed up the process for review and release of BSM funding.

Oversight organizations must rationalize their roles to the extent possible and eliminate unnecessary overlap, leverage assets to advise in a more effective manner; and recognize that quality cannot be achieved by repetitious, and at times, inefficient inspection.

Notwithstanding the need for a long-term modernization program, the IRS must also improve in the short term. Potential means of realizing short-term improvements may be organizational changes, process improvements, or modifications to the legacy technology base.

An IRS that performs better requires adequate funding as its workload continues to increase. As discussed in our interim report on the FY2002 budget, inadequate funding and resources will make it impossible for the IRS to meet any of its strategic objectives. The IRS still has a long way to go to reach the level of performance envisioned by both the IRS Restructuring Commission and the IRS Restructuring and Reform Act. Failure to provide adequate funding will deprive the IRS of resources it needs to make improvements in customer service and compliance.

The most important task the Oversight Board must perform this year is to help identify candidates to replace Commissioner Rossotti. During his five-year tenure Commissioner Rossotti provided the IRS with the leadership it needed as it went through the most dramatic change in its history. The changes he implemented while Commissioner will have a positive impact on IRS for many years into the future. His accomplishments have placed IRS on the right track to provide top-quality service and fairness to all taxpayers, and he should be commended for what

he has done to transform IRS into a performance-based organization. I believe he will be the first to say “ We have much further to go.”

RRA 98 requires the Oversight Board to recommend candidates to the President for the position of IRS Commissioner. The Oversight Board has exercised this responsibility by partnering with the Treasury Department to develop a Position and Candidate Specification describing the qualifications needed and hiring a search firm to identify qualified candidates.

The search has been difficult. The only thing harder than finding candidates for this most demanding of positions is the job of IRS Commissioner itself.

The Oversight Board believes the next Commissioner must have the competencies necessary to ensure that the IRS continues its transformation from an entity focused on internally generated quantity measures to one focusing on customer service driven by quantity and quality measures, and must be able to chart a steady course to balance calls for increased compliance and additional customer service, all within limited resources.

Qualified candidates be CEO caliber executives with relevant operational experience, preferably gained within an intensive information processing and customer-service environment where information technology (IT) has been used to support the business, and understand the leadership challenges of managing a 100,000 person plus organization. Qualified candidates must also possess credibility and stature, with a reputation for being a strong leader and manager, and having been an effective change agent. Additionally, candidates must be broad-based functionally, and be particularly adept at providing operational and technology leadership from a general management perspective.

The Oversight Board believes that Charles Rossotti has been all of this and more. We believe the country owes him a debt of gratitude for the public service he has given us in the last five years.